

Chapter 4

Regulatory Relief for Small Business

Synopsis

On March 29, 1996, President Clinton signed groundbreaking legislation that opens new doors for small businesses. The Small Business Regulatory Enforcement Fairness Act of 1996 (P.L. 104–121) provides small businesses with more opportunities to participate in the federal regulatory process.

The new law represents a major small business victory because it reinforces and strengthens the Regulatory Flexibility Act (5 U.S.C. §§601–612) and codifies some of the administration's small business initiatives.

The Regulatory Flexibility Act (RFA), originally passed in 1980, requires federal agencies to evaluate the impact of their regulations on small business and to offer flexible regulatory alternatives when a rule is being developed. The 1996 amendments allow small businesses to challenge new agency actions in court when the company is adversely affected or aggrieved because the agency has not complied with the Regulatory Flexibility Act. In addition, the 1996 amendments extend the act to cover Internal Revenue Service (IRS) interpretative rulemakings to the extent that the rulemakings have paperwork requirements.

Beyond amending the Regulatory Flexibility Act, the 1996 legislation provides regulatory compliance assistance for small businesses and new mechanisms for addressing enforcement actions by agencies. Many provisions in the new law reflect the administration's efforts in support of small business, including requirements that federal agencies reduce the penalties against small businesses in enforcement actions, perform better economic analyses when evaluating the impact of regulations, work with industry to develop and enforce regulations, and simplify regulations overall.

In recent years, America's small businesses have been concerned that governments do not fully understand and appreciate the cost and burden of regulations on small business. Congress, through passage of the Small Business Regulatory Enforcement Fairness Act, and the administration, through presidential directives, have made progress in addressing regulatory and paperwork concerns. The 1996 legislation, coupled with early administrative efforts, has shifted federal agencies' attention to the disproportionate regulatory burdens shouldered by small businesses.

Background

A 1994 survey commissioned by the U.S. Small Business Administration (SBA) documented the regulatory and paperwork burdens on small business.¹ The report revealed that the costs of regulatory compliance place a disproportionate burden on small firms. In fact, firms with 20-49 employees reported spending nearly 20 cents of every revenue dollar to pay for the paperwork and operating costs attributable to regulations. These costs do not include the additional capital investments needed as a result of regulation. In fact, the burden of compliance is as much as 50 percent more for small businesses than for their larger counterparts.²

Taken together, the costs of obtaining information about regulations and the true costs of complying fully with all regulations are daunting to small firms. Among the problems small businesses identify in complying with regulations are the following:

- An unclear understanding of what is required to comply;
- Frequent changes in regulations;
- High true costs (both direct and indirect) to fully comply; and
- Difficulties in obtaining clear answers to questions about compliance.

The SBA's Office of Advocacy, in cooperation with the White House Conference on Small Business, held a series of 15 focus groups between October 1994 and January 1995 to assess the future of small business and entrepreneurship in the 21st century.³ The focus groups identified regulations as one of the major barriers to small business market entry and an inhibitor of company growth. Every panel cited the extent, complexity, and uncertainty associated with regulations at all levels of government as impeding the establishment and growth of businesses. Participants agreed that policymakers should employ better cost-benefit analyses and risk assessment methods to develop simpler and more flexible regulations.

The Regulatory Flexibility Act

Small businesses' most significant mechanism for influencing the development of federal regulations is the Regulatory Flexibility Act. The law was originally passed in 1980 to ensure that federal agencies fit regulations to the scale of the affected businesses. Agencies are required to perform economic and

¹ Thomas D. Hopkins, *A Survey of Regulatory Burdens*, report no. PB95-263190 prepared by Diversified Research, Inc., for the U.S. Small Business Administration, Office of Advocacy (Springfield, Va.: National Technical Information Service, June 1995).

² U.S. Small Business Administration, Office of Advocacy, *The Changing Burden of Regulation, Paperwork, and Tax Compliance on Small Business: A Report to Congress*, report no. PB96-113642 (Springfield, Va.: National Technical Information Service, October 1995).

³ U.S. Small Business Administration, Office of Advocacy, *The Third Millennium: Small Business and Entrepreneurship in the 21st Century*, report no. PB95-241196 (Springfield, Va.: National Technical Information Service, 1995).

regulatory analyses, solicit and consider flexible regulatory proposals from small businesses, and explain the rationale for their regulatory actions.

When Congress passed the RFA in 1980, it spelled out reasons why regulations should not simply be applied uniformly to all businesses. In fact some of the best reasons were not simply for the benefit of business, but for the advantage of the public. Congress found that the failure to recognize differences in the scale and resources of regulated entities has in many cases discouraged innovation that leads to beneficial products and processes, restricted improvements to productivity, adversely affected competition in the marketplace, and created barriers to entry in many industries.

Many regulations have been applied uniformly to small and large businesses alike, even though the problems that gave rise to the government action may not have been caused by small firms. Uniform federal regulatory and reporting requirements have in many instances imposed unnecessary and disproportionately burdensome demands on small businesses with limited resources. The Regulatory Flexibility Act sets out specific processes for federal agencies to use in analyzing the impact of regulations on small businesses.

General Requirements

The Regulatory Flexibility Act requires agencies to take steps to collect input from small entities on proposed rulemakings and to determine whether a regulation is expected to have a significant economic impact on a substantial number of small entities. This evaluation must produce an economic analysis that substantiates an agency's actions. Moreover, federal agencies are required to identify alternative, flexible regulatory approaches for regulations affecting small businesses.

As agencies proceed through the administrative steps required by the act, the SBA's Office of Advocacy monitors regulatory development, reviews the agency's compliance with requirements for seeking small business advice, submits public comments on proposed rules and initial economic findings, and evaluates final rules and analyses.

The RFA also requires agencies to perform a periodic review of existing regulations. If a regulation has a significant economic impact on a substantial number of small entities, the agency must evaluate the rule every 10 years. Through a public review process, the agency must seek the comments of small businesses and the others in the public and must consider alternatives to minimize the impacts on small businesses.

Strengthening the RFA:

The Small Business Regulatory Enforcement Fairness Act

What happened in 1996? The small business community was successful in persuading Congress and the administration that a new law was needed to ensure full agency compliance with the RFA. The Office of Advocacy reports

to Congress every year on agencies' compliance with the RFA. These reports built a record of evidence that contributed to the decision of Congress and the President to reinforce the role of small businesses to ensure equal participation in regulation development.

The 1996 legislation—the Small Business Regulatory Enforcement Fairness Act—amended the RFA by allowing small businesses adversely affected or aggrieved by an agency's final action to seek judicial review. The court may evaluate the merits of a small business's case by reviewing an agency's compliance with the RFA. The new judicial review provisions demonstrate that the recommendations of small businesses and the Office of Advocacy are a serious consideration in regulatory decision making.

The amendments to the Regulatory Flexibility Act also include an important provision that expands the coverage of the law to IRS paperwork regulations, which generally were exempted in the original act. The paperwork burden of the Internal Revenue Service is a primary concern of small businesses, and the process of preparing a regular payroll is a constant reminder of the numerous regulations dealing with tax withholding and reporting.

Beyond amending the Regulatory Flexibility Act, the 1996 legislation provides regulatory compliance assistance for small businesses and new mechanisms for addressing enforcement actions by agencies. The law requires that federal agencies work with industry to develop and enforce regulations, reduce the penalties against small businesses in enforcement actions, perform better economic analyses when evaluating the impact of regulations, and simplify regulations overall.

Judicial Review

Under the amended RFA, a small business that is adversely affected or aggrieved by an agency's failure to comply with the act during the rulemaking process may seek review of the rule in court.

While not all provisions in the Regulatory Flexibility Act are subject to judicial review, the main elements can be scrutinized by the courts. The most important element of an agency's action is its economic analysis. If an agency determines that a rule will not have a significant economic impact on a substantial number of small entities, it must so certify and be able to justify its conclusion with a fact-based, quantitative analysis. The agency must request public comment on its certification, and the certification can be reviewed by the court.

If an agency determines that a rule will have a significant impact, it is mandated to complete a full regulatory and economic analysis and solicit small business review of its conclusions. Part of the analysis must be a serious consideration of alternative regulatory approaches that would relieve the burdens on small business. These analyses and conclusions, included in a final regulatory flexibility analysis, also are subject to judicial review.

One of the key questions that an agency must answer is: will a regulation have a significant economic impact on a substantial number of small entities?

Whatever an agency's answer, the data used for decisionmaking will be critically reviewed by a court. Commonly, agencies want a concrete definition of "significant impact" and "substantial number." Decisions about these terms clearly fall to the courts. The agency will be challenged to demonstrate the integrity of its decision model. Future courts' interpretations will color the effects of this law, but agencies can expect to be held to a high standard by the small business community.

The court may review 1) an agency's proper use of the definition of small business; 2) the final regulatory flexibility analysis, including the agency's efforts to evaluate alternative regulatory approaches and reasons for rejecting or accepting them; 3) the agency's effort to collect comments from small entities through a variety of mechanisms; 4) any decision to certify that a rule will not have an impact on small businesses and the factual basis for such certification; 5) a decision to delay the completion of a final regulatory flexibility analysis in the event of an emergency rulemaking; and 6) compliance with a requirement for periodic reviews of rulemakings at the 10-year anniversary of every rule or the enactment of the 1980 law, whichever is first.

Analysis

Small businesses, along with other Americans, enjoy the benefits that regulations help to create, among them a cleaner environment, fair market practices, and safer workplaces, roadways, and food. Agencies have an obligation to fulfill their missions to protect and advance American society.

At the same time, the benefits of regulation often are distributed broadly, while the costs tend to fall on specific businesses or people. As the Regulatory Flexibility Act highlights, these costs can be hard hitting for small firms. Agencies can advance the effectiveness of regulations by performing comprehensive economic analyses that include small business impacts and by developing flexible regulatory approaches. Under the Regulatory Flexibility Act, agencies are required to publish a small business analysis during regulation development.

Determining a rule's impact on small businesses and other small entities is an important part of the rulemaking process, and the validity of the RFA analysis will be a critical factor in decisions about an agency's compliance. President Clinton in 1993 directed executive agencies to restore the integrity and legitimacy of regulatory review and oversight and to make the process more accessible and open to the public.⁴ The Regulatory Flexibility Act extends these requirements to all federal agencies, requiring them to submit their analysis for public review and comment. With small business scrutiny, the analysis should be legitimate and defensible.

As the basis for new rules, an agency must establish a record of small businesses' contribution to the problem that is to be solved. The agency is

⁴ Executive Order 12866, September 30, 1993.

then obligated to produce a meaningful analysis of the effectiveness of proposed remedies and the impact of the regulation on the affected parties. Useful data on industry characteristics becomes very important when agencies are assessing the varying effects of regulations on different sized businesses. An analysis should place special emphasis on the ability of a small business to cover or recover costs of new regulation and how it will affect their competitive position with larger firms.

One common mistake in economic analysis is using the aggregate or mathematical average to determine the impact of a regulation on small business. The objectives of the Regulatory Flexibility Act will be achieved only if agencies complete thorough detailed analyses that isolate affected small business sectors. Variables should include different business size and industry classifications. In addition, the definitions used in an economic analysis also must withstand critical review. For example, agencies are compelled to use definitions for small business established by the U.S. Small Business Administration in their analyses for most cases. If an economic analysis uses alternative definitions, the agency must solicit the consultation of the Office of Advocacy and public review. This critical definition question and the analytical methodology are linchpins in an agency's demonstration of compliance with the Regulatory Flexibility Act.

Influence in Regulation Development

Participating in the development of regulations is an important right of small businesses. The administration has encouraged federal agencies to develop regulation in a cooperative environment. The passage of the Small Business Regulatory Enforcement Fairness Act has cemented the important role of small businesses in the regulation development process.

The RFA explicitly requires agencies to ensure that small businesses are engaged in the process. Agencies must solicit small business participation in rulemakings through industry publications, direct mail, public meetings, and electronic means.

EPA and OSHA Regulatory Review Panels

The amended Regulatory Flexibility Act requires an extra step for the Environmental Protection Agency (EPA) and the Occupational Safety and Health Administration (OSHA) in the development of regulations. Specifically, the act requires that the agencies receive input from affected small businesses before proposed rules are published.

For each significant proposal, EPA or OSHA convenes a Small Business Advocacy Review Panel. The interagency panel—including employees of the agency, the SBA's Office of Advocacy, and the Office of Management and Budget—review the draft proposed rule and economic or scientific analyses developed by the agency.

The panel is required to collect the advice and recommendations of small business representatives and complete a report on its findings. The agency uses the report to help determine the impact on small businesses and make revisions to the rule. This process is an important addition to the Regulatory Flexibility Act because it inserts small businesses into the early process and the panel report becomes a part of the public record.

Congressional Review

The Small Business Regulatory Enforcement Fairness Act has another provision that provides small businesses with an avenue for involvement in the regulatory approval process.

The 1996 law provides for congressional review of rulemakings by federal agencies. Before any rule goes into effect, agencies are required to give the Congress an opportunity to review the rule. Small businesses may use this as an opportunity to discuss the regulation with lawmakers. Major rules—those with a \$100 million impact on the economy or a major impact on an industry, government, or consumers; or those affecting competition, productivity, or international trade—cannot go into effect until congressional review is complete.

Compliance Assistance

The 1996 act also sets new objectives for agencies' compliance assistance efforts. While some federal agencies engage in cooperative programs or publish compliance manuals to assist regulated businesses, the Small Business Regulatory Enforcement Fairness Act goes further.

Federal agencies must publish compliance guides for all newly published rules with a significant small business impact. These guides must explain in plain language how the firms can comply with the regulations. If a small business is charged with noncompliance in an enforcement action, the court review may include the content of the small business compliance guide in assessing the reasonableness of the proposed penalty.

Small businesses that are confused by a regulation or need clarification often ask agencies for explanation. Under the new law, agencies also are required to establish a system for addressing compliance inquiries from small businesses. Any guidance provided by an agency will be considered as evidence of the reasonableness of proposed penalties, fines, or damages assessed against a small entity.

Finally, to step up compliance assistance, agencies are required to use the small business development centers as a point of distribution for compliance assistance. The centers are located in every state and offer one-stop assistance to small businesses. They are administered by the U.S. Small Business Administration as a cooperative program effort of the private sector, the educational community, and federal, state, and local governments.

Enforcement Actions

Small Business Ombudsman and Boards

The SBA Administrator is directed by the law to appoint a small business and agriculture regulatory enforcement ombudsman to work with each agency to receive comments from small businesses concerning enforcement-related activities conducted by agency personnel. In addition, regional small business regulatory fairness boards are established in each SBA region to advise the ombudsman on matters of concern to small business relating to the enforcement activities of agencies.

The law provides small businesses with a new venue for registering complaints about excessive enforcement actions by federal agencies. Because board members will be small business owners and operators, they will offer a less intimidating, but powerful process.

Penalty Policy

Under the new law, each agency must establish a policy to provide for the reduction and, under appropriate circumstances, waiver of civil penalties for violations of statutory or regulatory requirements by a small business. This provision codifies a directive issued by President Clinton in March 1995 for small business relief.

Equal Access to Justice

Small businesses are granted more opportunity to recover attorney fees under the 1980 Equal Access to Justice Act in litigation with the government. In administrative and judicial proceedings, if the government's demand is unreasonable when compared with the judgment or decision, then the small business can be awarded attorney fees and other expenses related to defending against the action. Allowable attorney fees were increased from \$75 to \$125 per hour.

Conclusion

While small businesses have been given new avenues to participate in the regulatory process, they must aggressively pursue their rights. Regulations will improve only when small businesses critique proposed regulations and agencies extend invitations to small businesses. Compliance will be achieved when both agencies and small businesses seek to work cooperatively. If their grievances about enforcement actions are to be addressed, small businesses must understand their rights and obligations in administrative and legal proceedings and use the processes wisely.

Only through vigilant efforts to participate in the process of governance will small businesses fully enjoy their rights.